Inland Revenue

Income Tax and Incapacity Benefit

These notes are for guidance only and reflect the tax position at the time of writing. They do not affect your right of appeal about your own tax.

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We produce a wide range of free leaflets each designed to explain a different aspect of the tax system in plain English. Some you might find useful are listed below.

IR80	'Income tax and married couples'
IR90	'Tax allowances and reliefs'
IR91	'A guide for widows and widowers'
IR93	'Separation, divorce and maintenance payments'
IR110	'A guide for people with savings'
IR120	'You and the Inland Revenue'
CGT14	'Capital gains tax - An introduction'
CGT15	'Capital gains tax - A guide for married couples'

Our 'Catalogue of leaflets and booklets' lists the publications you can get from Tax Enquiry Centres and Tax Offices. Their addresses are in your local phone book under 'Inland Revenue'. Most offices are open to the public from 9.30am to 4pm, Monday to Friday, and some are also open outside these hours.

Your local library or Citizens' Advice Bureau may also have copies of our leaflets.

Northern Ireland

Please note that the following terms used in this leaflet are different in Northern Ireland:

***Benefit Agency** - the Northern Ireland equivalent is the Social Security Agency.*

***Benefit Office** - the Northern Ireland equivalent is the Incapacity Benefit Branch, Castle Court, Royal Avenue, Belfast BT1 1SB.*

This leaflet is for people who are claiming Incapacity Benefit. It explains how Incapacity Benefit is taxed and how you can get help from the Tax Office if you need it.

Background

Incapacity Benefit is a new benefit for people under state pension age who are unable to work because of illness or disability, which replaces Invalidity Benefit and Sickness Benefit from 13 April 1995. It will be paid to people who are assessed as being incapable of working, and who have paid sufficient National Insurance Contributions to qualify. People who work for an employer will normally get Statutory Sick Pay for the first 28 weeks of sickness, and then move onto Incapacity Benefit at the short term higher rate.

The benefit is not means-tested, so any savings or income will not affect the rate of benefit payable. It will be paid at three basic rates:

• First 28 weeks of sickness	Short term lower rate
• Weeks 29 to 52	Short term higher rate
• After one year	Long-term rate

There are supplements which may be paid in addition to the basic rate.

These are adult dependency increases, child dependency increases and age additions.

Unlike the current Invalidity Benefit, Incapacity Benefit may be taxable.

Is all Incapacity Benefit taxable?

No. Incapacity Benefit paid for the first 28 weeks of sickness at the short-term lower rate is not taxable at all. Any Child Dependency Addition included in your benefit is not taxable either. The Benefits Agency will tell you if your benefit is taxable or not.

After the first 28 weeks you will only pay tax if your total taxable income, including Incapacity Benefit, is not covered by your tax allowances (Page 8 of this leaflet gives you more information about this).

What happens if I was already receiving benefit in April 1995?

If you were entitled to Invalidity Benefit before 13 April 1995, your benefit after that date is not taxable unless there is a break of more than 8 weeks in your claim. If you were entitled to Sickness Benefit, your Incapacity Benefit will be taxable when you start to receive the short-term higher rate of Incapacity Benefit.

How will I pay tax?

There are two ways depending on your circumstances.

- If you are still being paid by your employer, or if you have a pension, we will adjust your existing PAYE code number to take into account the amount of taxable benefit you receive during the tax year. This means that your benefit will be paid in full but the tax will be taken off your pay by your employer, or from your pension by whoever pays it.

- If this is not possible because Incapacity Benefit is your main or only taxable income, any tax due will be taken off your benefit by the Benefits Agency before it is paid to you.

How is the tax to be taken off my benefit .calculated?

The Benefits Agency will calculate any tax due when they prepare your Order Book or pay you your benefit. They will use a tax code like an employer. It will give your tax allowances so that, as far as possible, you will pay the correct amount of tax during the tax year.

About tax codes used by the Benefits Agency

We may use some technical terms which are unfamiliar to you, they are explained at the end of this leaflet.

If you are entitled to the tax allowances for married couples or blind people, you can use the Incapacity Benefit claim form to claim them.

They will be included in your tax code straightaway. Other allowances, such as the additional personal allowance, have to be given by the tax office. There are some allowances, however, that cannot be included in your code. This is because the code numbers used by the Benefits Agency can only give the more common tax allowances. If you are entitled to one of these other allowances, we will make sure you do not pay too much tax by either

- telling the Benefit Agency not to take any tax at all from your benefit, or
- using the allowance to reduce the tax deducted from any other taxable income you may have, or
- sending you a tax refund after the end of the tax year.

The tax office will check your code number and tell you what it is when you start to receive taxable benefit. We will send you a form P2 ('Notice of your income tax code') and a leaflet P3(IB) ('Incapacity Benefit: Understanding your tax code'). The leaflet explains what the various allowances are. If you need further information, we can send you leaflet IR90 ('Tax allowances and reliefs').

Do I need to tell the Tax Office about my benefit?

The Benefits Agency notify the Tax Office automatically when you start to get taxable Incapacity Benefit.

All that you need to do is to complete the tax section of the claim form so that we can give you the correct tax code.

However if you have a form P45 given to you by your last employer, hand it to the Benefit Office as soon as you can unless

- the Benefit Office has told you that your Incapacity Benefit is not taxable, and
- you intend to claim a repayment of tax (see below).

You should also declare taxable Incapacity Benefit if you receive a tax return.

Before receiving Incapacity Benefit I paid tax under PAYE. Am I entitled to a refund?

If

- you have paid tax under PAYE since 6 April, **and**
- the Benefits Agency has told you that any benefit you will receive before the following April is not taxable, **and**
- you do not receive a pension

then you are likely to be entitled to a refund of tax. To claim a refund you should

- make sure you have the form P45 given to you by your last employer,
- contact your Tax Office and ask for form P50, and
- complete Section C of the P50 and enter 'Short-term non-taxable Incapacity Benefit' (together with the date your benefit started) where the form asks you about benefits.

Return the form to your Tax Office with your P45.

However, if the Benefits Agency has told you that any of the benefit that you receive before the following 5 April will be taxable, any refund will be calculated after the end of the tax year without you needing to claim. We may be able to let you have a part repayment before the end of the year. You should claim using Section B of form P50 - however, you must do this before you start to receive taxable benefit.

Do I have to pay tax on any investment income I receive?

Most investment income is taxable. Usually the income will already have been taxed before you receive it. This means that you will have no further tax to pay unless you are liable at the higher rate of tax.

You can claim back some or all of the tax on your investment income if it is more than your liability for the year. This could be, for example, if

- your only other income is Incapacity Benefit, or
- you are only liable to pay the lower rate of tax of 20 per cent

Our leaflet IR110 - 'A guide for people with savings' gives further details.

If your total taxable income is not covered by your allowances and it includes investment income which has not been taxed - such as income from government stocks on the National

Savings Stock Register - you should give details to your Tax Office so that we can work out if any tax is due.

Where can I get help?

If you would like more information or you need help, you can contact any Tax Office or Tax Enquiry Centre. You can find the address and telephone number listed in the phone book under 'Inland Revenue'. It may be easier for you to get in touch with your own Tax Office if you already pay tax under PAYE on a pension, or if you are still getting paid by your last employer.

We have set up a special Tax Office in Leicester which will be responsible for your tax affairs if Incapacity Benefit is your only or main income.

The address is

HM Inspector of Taxes
Leicester 4 District
Attenborough House
109 -119 Charles Street
Leicester
LE1 1FZ

Telephone: 0116 2425 963
Minicom: 0116 2513 764

What do you mean by...?

We have tried to keep our explanations as simple as possible but we have had to use a few technical terms. These are explained below.

PAYE
Pay As You Earn is the system under which employers deduct tax from employees' earnings (or from private pensions) when they pay them, using a tax code. For Incapacity Benefit, the Benefits Agency acts like an employer but only operates a simplified form of PAYE.

Tax Code
Your Tax Code is worked out from your tax allowances. It tells the Benefits Agency or your employer or pension-payer how much tax (if any) to take off your benefit, pay or pension.

Tax Allowances
A tax allowance is not a payment to you. It is a way of reducing the tax you pay on your income. There are two types of allowance. The personal allowance is an amount of income you can receive without having to pay any tax. The married couple's allowance, and certain other allowances, reduce your tax bill by a fixed amount. The amounts of the allowances are announced in the Budget and can vary from year to year.

Tax Year
Any tax is based on your income for the tax year. This runs from 6 April to the following 5 April.

Lower, basic and higher rates
You pay tax at different rates depending on your income. In 1995-96, if your taxable income less your personal allowance was £3,200 or less you would pay tax at 20 per cent (the lower rate). You would pay tax at 25 per cent (the basic rate) on the next £21,100 and at the higher rate of 40 per cent on income above that.

Taxable Income
This includes

- taxable Incapacity Benefit
- state retirement pension
- pensions from previous employers
- widow's pension
- any earnings from a job or business
- Unemployment Benefit
- income from savings with a bank or building society
- taxable income from National Savings
- dividends
- interest from Government stocks
- income from property
- if you are married, your share of income which you receive jointly.